Mizuho Brief: AUD

Economics & Strategy | Asia ex-Japan

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MIZUHO

Questioning Relative AUD Bulls

1) What's behind recent, relative AUD out-run?

To be sure, **AUD tends to exhibit higher** (two-way) **volatility**, and is hence *liable for more, sometimes pronounced, episodes of out- and under-performance*.

Nonetheless, **AUD out-performance has been notable**, and hence must be conceded; even after accounting for inherent tendency for gyrations. And to be sure, there are a few good reasons for this.

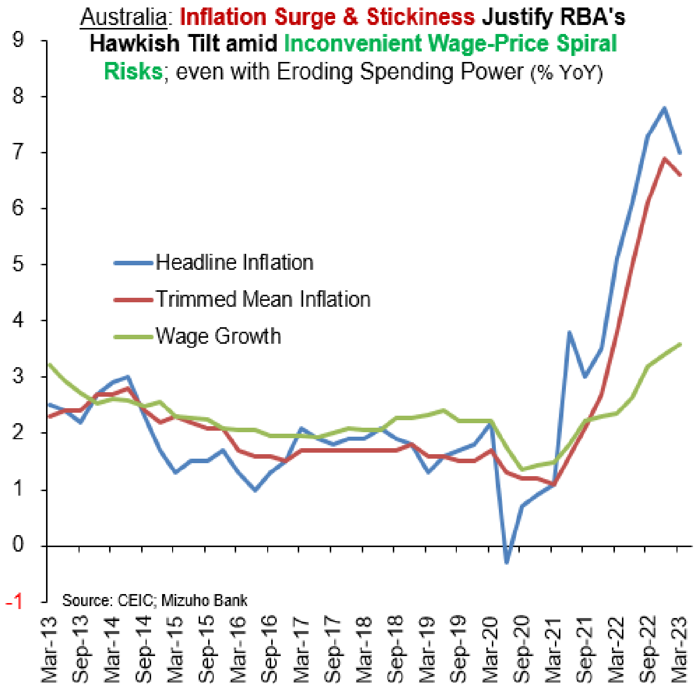
Key amongst them are;

i) a **distinctly more hawkish RBA**, and;
ii) growing (albeit intermittent) **bets on emphatic China stimulus** with amplified commodity pass-through, and;
iii) **housing revival** coincident to, and backed by, immigration.

What's worth noting however is that the **strength of the move on a conspiracy of factors should not be confused for** the **conviction/durability** of a trend. The latter requires an examination of underlying factors.

2) What's with the RBA's Hawkish Shift?

Hence the question of what's **motivating a hawkish RBA shift** (and how that will feed into the AUD). Most obviously, a confluence of **stickier-than-expected inflation**, and **tighter job market** conditions, which have a tendency to induce **greater wage-price risks** are most culpable.



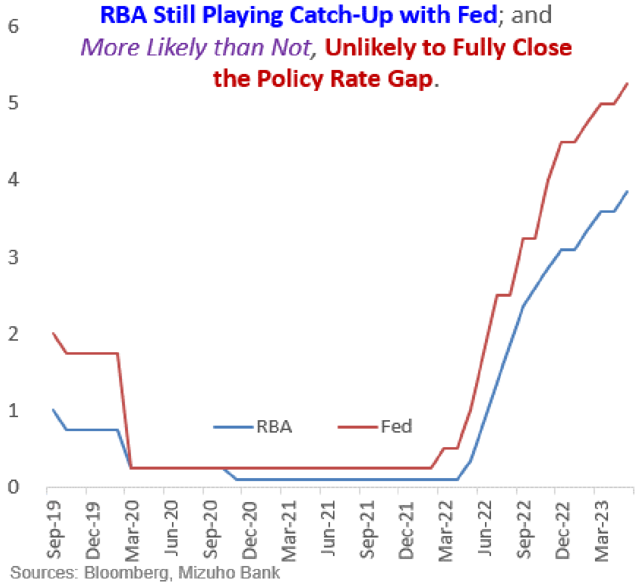
Especially as this is **accentuated by goods-to-services inflation migration** amid inward migration **straining somewhat more rigid capacity**.

What's more, the **positive turn in the housing market** from a conspiracy of these dynamics, and in particular driven by an influx of fairly price inelastic demand for homes, **further underpin the need for more restrictive monetary conditions**.

Not just because of coincident asset inflation and "wealth effects", but crucially, **as earlier policy restraint on account of adverse housing** (balance sheet) **risks are diminished**.

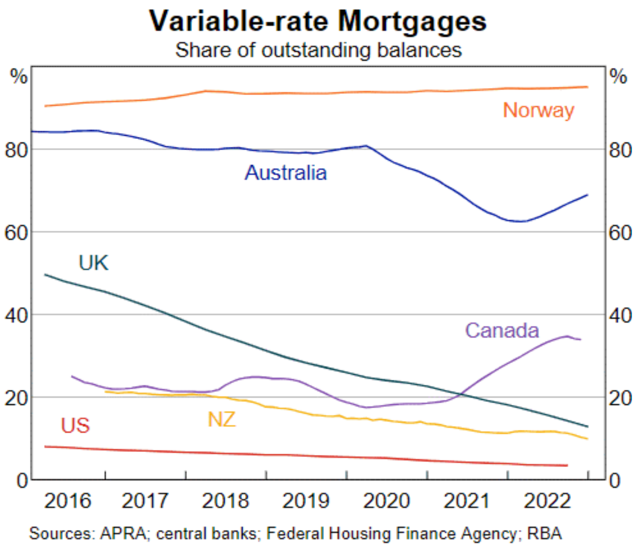
3) But Can a more Hawkish RBA "Carry" AUD?

Nonetheless, and in answer to the more pertinent question posed, the upshot is that a **more hawkish RBA**, while a baseline backstop, **cannot sufficiently, and durably "carry"** (pun intended) **AUD**. Specifically, incremental RBA hawkishness does not clear the bar on either nominal and real rates.



Thing is, while sounding more hawkish, the **RBA is merely playing catch-up** with the Fed, and is **unlikely to exceed the Fed's hawkish flex**.

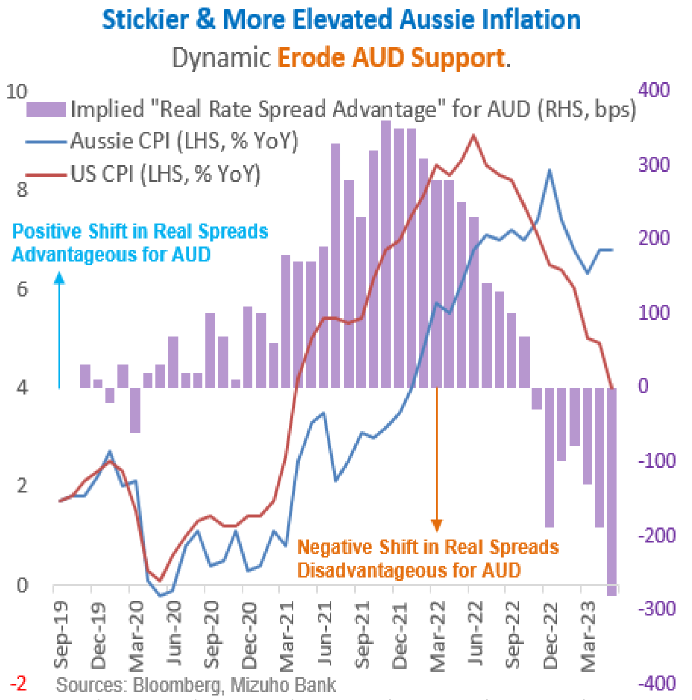
Especially as **Australia's exceptionally elevated household debt** (mortgage) at ~120% of GDP (88%) compared to US household indebtedness of ~66% (~45%) **compounded by much higher proportion of floating rate loans** (see 'Variable-rate Mortgage' Chart from RBA's Fed SOMP, below) suggests ***far more pronounced effective tightening for each equivalent hike*** is ***for the RBA hike*** compared to the Fed.



Consequently, the **RBA is likely to remain far more cautious and circumspect about being too brutal about hikes** as it accounts for much more forceful "transmission" of policy tightening.

In turn, the **RBA's "hawkish" "walk-to-talk ratio" is likely to fall short of the Fed's**; ***inevitably hampering the aspirations of more spirited AUD*** as a result.

What's more, **with Australia's inflation now more elevated than US inflation**, and liable to decline more gradually, will further accentuate the real rates shortfall vis-à-vis Fed



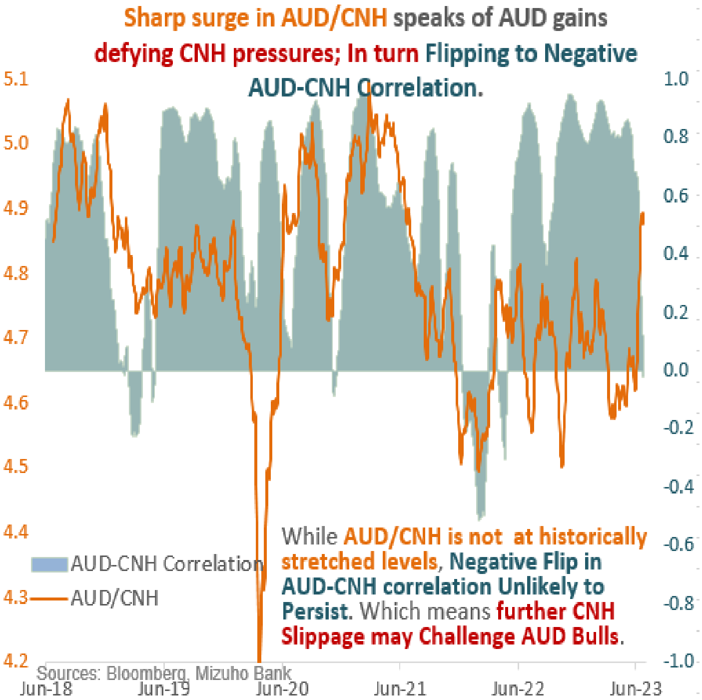
4) Why China Won't Inspire AUD Bulls

Admittedly while **China stimulus plans**, especially if it is driven by fresh impetus in support of by infrastructure, housing, electrification, could provide a **fillip to AUD** *via hard commodity channels*.

But this is **likely to fizzle not dazzle** given the inherent and limitations on China's scope and breadth of stimulus. At least in the near-term as China stimulus looks vulnerable to **hit a wall on global downturn forces being juxtaposed against geo-politics**. This is a combo that **tends to spook commodities**.

Especially amid high rates that dampen the investment channels of commodity boost; **leaving flagging ToT as an inadequate thrust**.

What's more, **CNH headwinds at odds with AUD** upside, while not unprecedented or outlandish, may be a **stretched state of FX dynamic on borrowed time**.



Fact is, **if CNH pressures continue to mount**, it is **highly likely that AUD bulls** (relative or not) **will be challenged**; especially **given exceptionally large trade and investment linkages**; ***further amplified via commodity channels***.

5) Will Housing Charm AUD Bulls?

Admittedly, any **boost to the Aussie housing market** alongside immigration dynamics **not only play into the hard commodity shine** but are also **primed to provide a leg-up for AUD** via **capital inflows**. In particular alongside perceptions of **RBA hawkish tilt**.

But this is a lift channel that requires other stars to align. And so the short answer is that housing boost is but just one leg of a three-legged AUD stool. And the other two (RBA-rate spreads and China/global demand amplified by commodities) remain wobbly.

Upshot being, *China stimulus disappointment* risks alongside *eroding real rate spreads*, *risk re-pricing* and *commodity headwinds* from a **global slowdown suggest episodic, if not entrenched, downside AUD risks** in the next 6-9 months; before conditions shift in favour of relatively more solid footing to be regained for relatively more sustained gains into H2 2024.